United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT.

THE CITY OF SANTA CRUZ,
Plaintiff in Error,
against
ALBERT H. WAITE,
Defendant in Error.

IN ERROR TO THE CIRCUIT COURT OF THE UNITED STATES FOR THE NORTHERN DISTRICT OF CALIFORNIA.

Brief on Behalf of Defendant in Error on Petition for Rehearing.

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AGAINST

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BRIEF ON BEHALF OF DEFENDANT IN ERROR ON PETITION FOR REHEARING.

Statement of the Case.

The evidence showed, and the Circuit Court found, and this Court also held, that the plaintiff is a *bona fide* holder of the bonds and coupons in question, or, what is the same thing, that he derives his title from such *bona fide* holder. This statement does not include the three bonds and coupons mentioned in Finding 3 of Findings of Fact by the Circuit Court (Record, p. 34).

A *bona fide* holder is a purchaser for value without notice, or the successor of one who was such purchaser.

McClure vs. Orford Township, 94 U. S., 429.

If any previous holder of the bonds in suit was a *bona fide* holder for value, the plaintiff can avail himself of such previous holder's position without showing that he has himself paid value.

Montclair vs. Ramsdell, 107 U. S., 147.

Even though he may have notice of infirmities in its origin, a purchaser of a municipal bond from a *bona fide* holder before maturity takes it as free from such infirmities as it was in the hands of such holder.

Douglass County vs. Bolles, 94 U. S., 104.
Marion County vs. Clark, 94 U. S., 278.
Cromwell vs. Sac County, 96 U. S., 51.
San Antonio vs. Mehaffy, 96 U. S., 312.
City of Nauvoo vs. Ritter, 97 U. S., 389.

Recitals in Bonds in present case.

The bonds involved in the present case contain recitals as follows:

"This bond is one of a series of bonds of like date, tenor, and effect, *issued by the said City of Santa Cruz, for the purpose of refunding the bonded indebtedness of said city* and issuing bonds therefor, and providing for the payment of same *under and in pursuance of and in conformity with* the provisions of an act of the legislature of the State of California, entitled 'An act to amend an act entitled "An act authorizing the common council, board of trustees, or other governing body of any incorporated city or town, other than cities of the first class, to refund its indebtedness, issue bonds therefor, and provide for the payment of the same" (approved March 15, 1883),' approved March 1, 1893.

"*And in pursuance of and in conformity with* the Constitution of the State of California, and the ordi-

nances of the city of Santa Cruz, and in pursuance of and in conformity with a vote of more than two-thirds of all of the qualified electors of said city of Santa Cruz, voting at a special election *duly and legally called* and held and conducted in said city as provided under said act, on Tuesday, the thirteenth day of March, 1894, *notice thereof having been duly and legally given and published in the manner as required by law*, and after the result of said election had been canvassed, found and declared in the manner and as required by law.

"And it is hereby certified and declared that *all acts, conditions and things required by law to be done precedent to and in the issue of said bonds, have been properly done, happened, and performed in legal and due form, as required by law*" (Record, pp. 9, 10).

The alleged illegality in the issue of the refunding bonds in question was that they were issued in part to refund bonds of a water company, which water-company bonds the city had assumed upon the purchase of the water plant, agreeing to pay the same; thus, in substance and effect, making them the bonds of the city. It is claimed by the city, and the opinion of this court assumes, that any purchaser of these refunding bonds is bound to look at the ordinances, notices and proceedings of the city authorizing the issue of these refunding bonds.

It is further claimed that, if the ordinance calling the election had been examined by a person intending to purchase the refunding bonds, he would have seen therein the notice of election, and that such notice of election stated that the refunding bonds were issued in part for the purpose of refunding water-company bonds thus assumed by the city.

We do not admit that the water-company bonds thus assumed by the city were not bonds of the city within the meaning of the statute that authorized the city to issue refunding bonds. But whether they were or not

is immaterial so far as a *bona fide* holder of refunding bonds is concerned.

I.

We respectfully submit to the Court that its opinion rendered in this cause is erroneous, in that the said opinion holds that a bona fide holder of the refunding bonds and coupons in question, notwithstanding the said bonds and coupons are negotiable, and notwithstanding the recitals in the said bonds, is bound to look at and examine the ordinances, notices or other proceedings of the city under which the bonds were issued, particularly the ordinance calling the election, in which ordinance was set forth the notice of election and in which notice was the statement that the bonds were issued in part for refunding water company bonds assumed and agreed to be paid by the city.

The numerous cases decided in the Supreme Court of the United States as to the effect of negotiability of bonds, and also as to the effect of recitals therein, such as the recitals contained in the present bonds—especially the cases of *Evansville vs. Dennett*, 161 U. S., 434, *Graves vs. Saline County*, 161 U. S., 359, and *Gunnison County Commissioners vs. E. H. Rollins & Sons*, 173 U. S., 255—are conclusive to the effect that a *bona fide* holder of such negotiable bonds or coupons, containing such recitals, is not bound to look at or

examine the ordinances, notices or other proceedings of the city authorizing the issue of the bonds.

It is well settled that municipal bonds, payable to bearer and the coupons thereof, such as are the bonds and coupons in the present case, are negotiable instruments; that is, negotiable according to the law merchant. It is, of course, not necessary to cite to this Court the numerous decisions of the Supreme Court of the United States to this effect. This negotiability means something. It means that an instrument of this kind for the payment of money, payable to bearer, is intended to pass by delivery from hand to hand, and to give a good title thereto to the person who pays his money therefor without any notice of any illegality in respect thereof. The further effect of such negotiability is to cut off the maker from setting up any defense to such instruments, except that he did not make the instruments (in other words, what was known at common law as the plea of *non est factum*), and as respects municipal corporations this includes everything except the question whether there was power given in the Constitution or statute to issue such bonds. As respects such negotiable instruments, the maker thereof, whether the maker be a municipal corporation or an individual, cannot set up any defense such as that it or he did not receive payment for the bonds, or that the bonds were in fact issued for an unauthorized purpose, or that the proceeds of the said bonds were in fact appropriated in whole or in part to an unlawful purpose. When there is power given by statute to issue such negotiable instrument, and such instrument has been issued, and has passed into the hands of a *bona fide* holder for value, it is too late to set up any such defense. This results from the mere negotiability of the bonds under the law merchant, as has

been decided in numerous cases in the Supreme Court of the United States and in other courts.

The principles which apply as to negotiable instruments, where such instruments have come into the hands of *bona fide* holders, are well stated by Chief-Justice BIGELOW in the case of *Fearing vs. Clark*, 16 Gray (Mass.), 74 (approved by the U. S. Supreme Court in the case in 170 U. S., 593, 604, next cited in this brief), where the court says:

"The defendant proved no facts at the trial which constituted a valid defense to the note declared on as against the plaintiff, who is a *bona fide* holder for value, without notice. The rule is well settled that, when a note is transferred by a party to whom it is entrusted without authority, or fraudulently, it will be valid as against the maker in the hands of a holder who takes it *bona fide* without notice of the special circumstances under which the note came into the possession of the payee or agent of the maker who puts it in circulation. In such case the maker or endorser who places it in the hands of another for the purpose of being used in a particular way or for a special object takes the risk of its being used in a different way, and cannot refuse to pay it to any *bona fide* holder into whose hands it may come (Chit. Bills (10th ed.), 198; *Sweetser vs. French*, 2 Cush., 309). It is undoubtedly true that, as between the original parties to a note, or those who take it with notice, it is essential that there should have been a delivery of the note by the maker to take effect as a contract. In this sense delivery is included in the allegation of making. But the rule is qualified and limited as between the maker and a *bona fide* holder. In such case a valid delivery can be made by any person to whom the maker has given the note in such form as to enable him to hold himself out as absolute owner of the note. The case of *Putnam vs. Sullivan*, 4 Mass., 45, is a strong one on this point. There the notes were delivered to a clerk to be used for special purposes only, and it was held that a delivery by the clerk, whether through deception practiced on him or by a voluntary violation of the trust reposed in him, must be deemed in law, as against a *bona fide* holder, a delivery by those who were liable on the notes. The rule is different in regard to a deed, bond or other instrument placed into the hands of a third person as an escrow, to be deliv-

ered on the happening of a future event or contingency. In that case no title or interest passes until a delivery is made in pursuance of the terms and conditions upon which it was placed in the hands of the party to whom it was intrusted. But the law aims to secure the free and unrestrained circulation of negotiable paper, and to protect the rights of persons taking it *bona fide* without notice. It therefore makes the consequences which follow from the negotiation of promissory notes and bills of exchange through the fraud, deception or mistake of those persons to whom they are intrusted by the makers, to fall on those who enabled them to hold themselves out as owners of the paper *jure disponendi*, and not on innocent holders who have taken it for value, without notice."

Another case in point is *Provident Trust Company vs. Mercer County*, 170 U. S., 593. The facts in that case were that the County of Mercer, Kentucky, had subscribed for stock and voted bonds in aid of the construction of the Louisville Southern Railroad. The statute which authorized the issue of the bonds provided (p. 594):

"SEC. 4. The said bonds shall not be binding and valid obligations until the railway of the said company shall have been so completed through such county that a train of cars shall have passed over the same, at which time they shall be delivered to said railroad company in payment of the subscription of such county, and the county shall thereupon be entitled to receive certificates for the stock subscribed, and the county judge of such county shall order that such bonds *shall be deposited with a trustee or trust company, to be held in escrow, and delivered to the said railroad company when it shall become entitled to the same by the construction of its road through such county: Provided, however*, that such trust company or trustee shall, before receiving such bonds, give bond, with good surety, approved by the county judge, for the faithful performance of his or its duty in the premises: *And provided, further*, that no such subscription shall be binding unless such railroad shall pass to or through the corporate limits of the town of Harrodsburg."

The bonds in question in that case were deposited

with a trustee, as provided by said section 4. Afterwards the said trustee delivered the bonds to the railroad company. The county made default in the payment of the interest on the bonds. The Provident Life and Trust Company, a *bona fide*-purchaser of certain of said bonds, brought an action for interest thereon. The defense set up by the county was that the bonds had been delivered by the trustee contrary to the terms of section 4 of the statute above quoted, in that the railroad company had not constructed its road so as to entitle it to the delivery of the bonds at the time such delivery was made by the trustee. This defense was held good by the United States Circuit Court of Appeals for the Sixth Circuit, but the Supreme Court of the United States reversed this judgment. Mr. Justice BREWER, giving the opinion of the Supreme Court, says (p. 604):

"But if the true, the only permissible, construction be otherwise, and the demand of the statute is that the road be actually constructed from the north to the south line of the county, and so constructed that a train of cars shall have passed over it, then the question arises as to the effect of the decision of the trustee that the condition had been complied with, and of his delivery of the bonds, and their subsequent purchase by a *bona fide* holder. It is said that the bonds were placed in escrow, and that when an instrument is so placed there can be no valid delivery until the condition of the escrow has been performed, and if without performance the instrument passes out of the hands of the one holding it in escrow it is not enforcible against the maker, and that in a suit on the instrument the inquiry is always open whether the condition of the escrow has been performed. Whatever may be the rule in case the instrument so placed in escrow be a deed or non-negotiable contract, we are of opinion that a different rule obtains when the instrument is a negotiable obligation.

"'It is generally agreed that a delivery of negotiable paper left in escrow, contrary to the terms upon which it was to have been delivered, will pass a good

title to the *bona-fide* transferee for value and before maturity.'

"*Long Island Loan and Trust Co.* v. *Columbus etc. Railway*, 65 Fed. Rep. 455, 458.

"In *Fearing* v. *Clark*, 16 Gray, 74, 76, Chief Justice BIGELOW thus states the law:

"'The rule is different in regard to a deed, bond or other instrument placed in the hands of a third person as an escrow, to be delivered on the happening of a future event or contingency. In that case, no title or interest passes until a delivery is made in pursuance of the terms and conditions upon which it was placed in the hands of the party to whom it was intrusted. But the law aims to secure the free and unrestrained circulation of negotiable paper, and to protect the rights of persons taking it *bona fide* without notice. It therefore makes the consequences which follow from the negotiation of promissory notes and bills of exchange through the fraud, deception or mistake of those persons to whom they are entrusted by the makers, to fall on those who enable them to hold themselves out as owners of the paper *jure disponendi*, and not on the innocent holders who have taken it for value without notice.'

"In *Burson* v. *Huntington*, 21 Michigan, 415, 433, it is said:

"'If the maker or indorser, before delivery to the payee, leave the note in the hands of a third person as an escrow, to be delivered upon certain conditions only, * * * and the person to whom it is thus intrusted violate the confidence reposed in him; and put the note into circulation; this, though not a valid delivery as to the original parties, must, as between a *bona fide* holder for value, and the maker or indorser, be treated as a delivery, rendering the note or indorsement valid in the hands of such *bona fide* holder.'

"See also *Vallett v. Parker*, 6 Wend. 615, 620; *Chase National Bank v. Faurot*, 149 N. Y. 532; *Graff* v. *Logue*, 61 Iowa, 704.

"Within these authorities it must be held that when the trustee adjudged that the condition had been complied with and delivered the bonds the railroad company took such a title as, transferred to a *bona fide* holder, enabled him to recover against the county, notwithstanding the condition had in fact not been performed. That the trustee was the agent of the county and responsible to it for the manner in which he discharged this duty is obvious from the provision in the statute that he shall give 'bond, with good surety,

approved by the county judge, for the faithful performance of his duty. If in case the condition was not performed the county had a perfect defense to the bonds, even in the hands of a *bona fide* holder, there were little need of requiring the trustee to give any security."

Graves vs. Saline County, 161 U. S., 359, in point and controlling.

We next call the special attention of the court to the case of *Graves vs. Saline County*, 161 U. S., 359 (1896), for the following reasons:

1. That case, like the case now under consideration, involved the validity of *refunding bonds*, which stand upon a peculiarly favored footing.

2. The bonds which were refunded in that case had been decided by the Supreme Court of Illinois (84 Ill., 292), and were admitted by the Supreme Court of the United States (128 U. S., 526, 538), as stated in *Graves vs. Saline County*, 161 U. S., 359, 372, to have been void and uncollectible even in the hands of *bona fide* holders.

3. The recitals in the bonds which were held valid in *Graves vs. Saline County* were not as broad or as specific as the recitals in the bonds now in suit. On the contrary, the bonds now in suit contain the same recitals in effect that were made in the bonds in *Graves vs. Saline County*, and in addition the specific recital that "all acts, conditions and things required by law to be done precedent to and in the issue of said bonds have been properly done, happened and performed in due and legal form as required by law."

4. The statute under which the Saline County re-

funding bonds were issued required a record to be kept containing matters which if the bondholder was bound to notice would have shown the invalidity of the bonds which were refunded in that case.

As we consider the case of *Graves vs. Saline County* as controlling and decisive in its facts and in its principles of the case at bar, we now state the same at considerable length. In that case the facts were that the County of Saline, State of Illinois had issued $195,000 funding bonds under an act of February 13, 1865, and acts amendatory thereto, approved April 27, 1877, and June 4, 1879. These $195,000 of bonds were issued to fund one set of bonds formerly issued by the county in payment of the subscription to stock of the St. Louis and Southeastern Railway Company, and another set of bonds issued by the county to the Belleville and Eldorado Railroad Company. The Supreme Court of the United States expressly held and stated that the set of bonds issued to the Belleville and Eldorado Railroad Company were absolutely void even in the hands of *bona fide* holders, the court stating (p. 373):

"If the present case stood only on the footing of the original conditional contract of subscription, we would be compelled to follow the holding of the Supreme Court of Illinois, and to hold that *the original bonds were uncollectible even by innocent holders.*"

The Supreme Court then proceeded to state and consider the fact that the said void bonds had been funded under the said statutes and by authority of a vote of the people of the County, and expressly held and decided that the funding bonds so issued were valid bonds of the County in the hands of *bona fide* holders. The questions certified by the Circuit Court of Appeals on this point were as follows (p. 367):

"FIRST. Is the County of Saline estopped by the recital in the funding bonds to assert that the bonds issued to the St. Louis and Southeastern Railway Company and to the *Belleville and Eldorado Railroad Company*, respectively, and for which the funding bonds were exchanged, were not binding, subsisting legal obligations of said county?

"SECOND. *Are the funding bonds so issued by the County of Saline legal, valid and binding obligations upon said county in the hands of a bona fide holder for value before maturity?*

"THIRD. If the court should be of opinion that the funding bonds are invalid, would it be competent for the court in this cause, which is a suit in equity instituted by the County of Saline to restrain officers of the law from levying and collecting a tax as required by law to pay the interest upon the funding bonds, to grant the relief asked only upon condition that the County of Saline pay to the holders the amount of the valid bonds issued to the St. Louis and Southeastern Railway Company which were exchanged for the funding bonds?"

And the court said in answering these questions (p. 375):

"We, therefore, answer the second question put to us by the Circuit Court of Appeals in the affirmative, and this renders a formal answer to the other questions unnecessary."

In this case of *Graves vs. Saline County*, the Statutes of Illinois, following the universal rule, required that the action of the county officers in issuing the funding bonds, like all other proceedings of the county, be *entered upon the records of the county*; and, if any one had examined those records and proceedings, he would have seen that those bonds were issued to fund other bonds issued to the Belleville and Eldorado Railroad Company, which last mentioned bonds were absolutely void. Not only so, but the statute under which these Saline County bonds were issued (S. L. Ill., 1879, p. 229, § 4) expressly provided, among other things, as follows:

"Upon the issuing of any new bond, or evidence of indebtedness, the clerk, or other officer having custody of the records of the fiscal matters of such county, city, town, township, school district or other municipal corporation, as the case may be, shall make registration thereof, in a book to be kept in his office for that purpose, showing the date, amount, number, class, date of maturity, rate of interest and place of payment of such new bond, or other evidence of indebtedness, and **the description of the bond or evidence of indebtedness, for which, or for the purchasing or retiring of which, the same was given,** as nearly as practicable."

An examination of this record and register kept of these Saline County funding bonds would have shown that these funding bonds were issued to take up the void bonds issued to the Belleville and Eldorado Railroad Company.

Void Even in the Hands of Bona Fide Holders.

The very point of the decision of the Supreme Court of the United States in this case of *Graves vs. Saline County* in regard to such funding bonds was that, although the original bonds which were funded were absolutely void in the hands of *bona fide* holders, yet the *bona fide* holder of the funding bonds was not bound to investigate and ascertain at his peril as to whether the funding bonds were issued to fund a valid debt of the county, but was protected by the fact that the bonds were negotiable and by the recitals contained therein. After the decision of the Supreme Court of the United States in *Graves vs. Saline County*, 161 U. S., 359, the United States Circuit Court of Appeals for the Seventh Circuit, in obedience to the decision of the Supreme Court of the United States, held in favor of the validity of the said bonds (see *Graves vs. Saline County*, 73 Fed. Rep., 920).

Evansville vs. Dennett. Controlling.

THE PRECISE QUESTION involved in the present case has been passed upon by the Supreme Court of the United States in *Evansville vs. Dennett*, 161 U. S., 434, (1896).

Inasmuch as we also consider this case of *Evansville vs. Dennett*, 161 U. S., 434, to be controlling, we feel justified in stating the same at considerable length, more especially as the Court held in favor of a *bona fide* holder that, though the bonds recited *a particular resolution of the city council by date*, and though such resolution was by law required to appear on the records of the city, nevertheless the *bona fide* holder of such bonds was not even put upon inquiry as to the terms or contents of such resolution, nor of ordinances also referred to in such bonds.

In that case bonds were issued under the provisions of section 30 of the charter of the city of Evansville, Indiana, approved January 27, 1847, which gave power to take stock in any chartered company for making roads to said city (Report, p. 437, bottom, p. 440, bottom). There were two sets of bonds involved in the Evansville case. Those issued to the Evansville, Henderson and Nashville Railroad Company contained the following recital :

"This being one of a series of three hundred bonds of like tenor and date, issued by the city of Evansville, in payment of a subscription to the Evansville, Henderson and Nashville Railroad Company, made *in pursuance of an act* of the legislature of the State of Indiana and ordinances of the city council of said city passed in pursuance thereof."

The other issue of bonds recited as follows :

"*By virtue of an act* of the general assembly of the State of Indiana, entitled 'An act granting to the

citizens of the town of Evansville, in the county of Vanderburg, a city charter,' approved January 27, 1847; and by virtue of an act of the general assembly of the State of Indiana, amendatory of said act, approved March 11, 1867, conferring upon the city council of said city power to take stock in any company authorized for the purpose of making a road of any kind leading to said city; and by virtue of the resolution of said city council of said city, passed October 4, 1869, ordering an election of the qualified voters of said city upon the question of subscribing three hundred thousand dollars to the capital stock of the Evansville, Carmi and Paducah Railroad Company, and said election, held on the 13th day of November, 1868, resulting in a legal majority in favor of such subscription, and by virtue of a resolution of said city council, passed May 23, 1870, ordering an issue of the bonds of the city of Evansville (of which this is a part) to an amount not to exceed three hundred thousand dollars, bearing interest at the rate of seven per cent. per annum, for the purpose of paying the subscription as authorized above. The said city of Evansville hereby acknowledges to owe and promises to pay," &c.

The Supreme Court of the United States held that it must look alone to the charter of 1847 for the power to issue the bonds, saying (p. 440):

"Under this presentation of the case we put aside the acts of 1865 and 1867, as giving no support to the rights of the plaintiff, and look alone to the charter of 1847."

The court then proceeded to state that this charter gave power to subscribe for stock, but only on petition of two-thirds of the residents of the city, &c., as stated in section 30 of the charter, quoted in the Report, page 437, bottom.

The questions certified by the Court of Appeals to the Supreme Court in that case are as follows:

"1. Does the recital in the series of bonds, issued in payment of subscription to the Evansville, Henderson & Nashville Railroad Company, that they were issued 'in pursuance of an act of the legislature of the State of Indiana and ordinances of the city council of such

city, passed in pursuance thereof,' put a purchaser upon inquiry as to the terms of the ordinances under which the bonds were issued?

"2. Does the recital in the series of bonds issued to the Evansville, Carmi & Paducah Railroad Company that they were issued 'by virtue of a resolution of said city council passed May 23, 1870,' put a purchaser upon inquiry as to the terms of that resolution and charge him with knowledge of its terms?

"3. Do the recitals in the bonds issued to the Evansville, Carmi & Paducah Railroad Company, as against a *bona fide* purchaser for value of such bonds, estop the city of Evansville from asserting that such bonds were not issued, for stock subscribed, upon a petition of two-thirds of the resident freeholders of the city, distinctly setting forth the company in which stock was to be taken and the number and amount of shares to be subscribed?

"4. Under the recitals in the bonds issued to the Evansville, Carmi & Paducah Railroad Company was a *bona fide* purchaser for value put upon inquiry to ascertain whether a proper petition of two-thirds of the residents of Evansville, freeholders of that city, had been presented to the common council before that body had subscribed for stock in the said railroad company?

"5. Was a *bona fide* purchaser for value of the bonds issued to the Evansville, Carmi & Paducah Railroad Company charged by the recitals in said bonds with notice that they were issued in pursuance of an invalid act and in pursuance of an election under it, or had such a purchaser a right to assume, from the recital, that the prerequisites of both the valid act and the invalid act had been observed by the common council before the issuance of such bonds?"

The court answered all these questions in favor of the *bona fide* holder. It answered the first, second and fourth in the negative, and the third in the affirmative; and it answered in the negative the first clause, and in the affirmative the second clause, of the fifth question.

The Court, quoting from *School District vs. Stone*, 106 U. S., 183, 187, says (p. 443):

"Bonds issued by municipal officers containing recitals by such officers that the bonds have been issued 'in pursuance of,' or 'in conformity with,' or 'by

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virtue of,' or 'by authority of,' the statute have been held in favor of *bona fide* purchasers for value **to import full compliance with the statute, and to preclude inquiry** as to whether the precedent conditions had been performed before the bonds were issued," citing various cases.

Then, referring to the case in hand, the court adds:

"**As, therefore, the recitals in the bonds import compliance with the city's charter, purchasers for value having no notice of the nonperformance of the conditions precedent, were not bound to go behind the statute conferring the power to subscribe, and to ascertain, by an examination of the ordinances and records of the city council, whether those conditions had, in fact, been performed. With such recitals before them they had the right to assume that the circumstances existed which authorized the city to exercise the authority given by the legislature**" (*Ib.*, p. 443).

We call the special attention of the Court to the fact that the precise question put by the Circuit Court of Appeals to the Supreme Court of the United States in this case of Evansville vs. Dennett, in the first question above quoted, was whether the recital in the bonds that they were issued under "ordinances of the City Council put a purchaser upon inquiry as to the terms of the ordinances under which the bonds were issued." Also, that the second question submitted was whether the recital in the other series of bonds that they were issued "by virtue of a resolution of said City Council, passed May 23, 1870," thus specifying and referring to the resolution by the exact date thereof, "put a purchaser upon inquiry as to the terms of that reso-

lution and charge him with knowledge of its terms."

The Supreme Court of the United States answered both these questions in the negative. In other words, the Supreme Court of the United States has, in this case as in others, distinctly and emphatically laid down the doctrine that, while a purchaser of such negotiable bonds must examine to see if the constitution and statutes of the State confer authority to issue such bonds, and must also examine the form of the bonds and see what appears upon the face thereof, yet if the said bonds on their face conform to the statute and constitution and recite that they are issued "by virtue of" or "in pursuance of," &c., &c., authority of the provisions of a statute, the holder is not bound to go behind the statute conferring the power and ascertain by an examination of the ordinances, resolutions and proceedings of the City Council whether the city has complied with the provisions of the statute, or whether the facts exist which are required by the statute in order that bonds be issued.

Fundamental Principles of the Law of Negotiable Paper as Applicable to this Case.

These and other decisions of the Supreme Court of the United States are made in view of the great and fundamental principle involved in the negotiability of municipal bonds like other negotiable paper. The bonds are designed to pass from hand to hand upon payment of value therefor. The holder must look for constitutional and statute authority for the issue of the bonds, and must look at the bonds that he is buying, but he is not bound to look beyond this if the recitals in the bonds import a compliance with the constitution and statutes. Consider for a moment what an unrea-

sonable and impracticable burden any other rule or principle would put upon the purchaser of municipal bonds. Nobody would be safe in buying them unless he or his attorney went personally and examined all the records of the municipality. In the present case this would have meant that the purchasers of these bonds would have to make a journey across the continent to examine all the records of the municipality. How many bonds would any municipality be enabled to sell if this were the law? The practical effect of any such rule would be to render all negotiable bonds non-negotiable. If a State desires that its municipalities shall not issue negotiable bonds it is very easy for the legislature so to provide; but, as was said by Mr. Justice HARLAN in the case of *Gunnison County Commissioners vs. E. H. Rollins & Sons*, 173 U. S., 255, 276:

"Indeed, it is entirely competent for a State to provide by statute that all obligations, in whatever form executed by a municipality existing under its laws, shall be subject to any defense that would be allowed in cases of non-negotiable instruments. But for reasons that every one understands no such statutes have been passed. Municipal obligations executed under such a statute could not be readily disposed of to those who invest in such securities."

Nothing Peculiar in the Case at Bar as to Keeping Records.

But it may be objected that in the present case the California statute required that "the notice of such election shall recite the indebtedness to be refunded." The court says that the action of the mayor and council was by ordinance, and that such ordinance was a part of the public records of the city, which by its charter are required to be kept "in large, well-bound, uniform and suitable books."

These provisions, however, are not peculiar to the present case. In the *Evansville Case*, 161 U. S., 434, the charter of the city of Evansville (S. L. Ind., 1847, p. 9, § 26) provided, among other things, as follows:

"The common council shall keep a full and fair record of all their proceedings, and for this purpose shall appoint some person not of their body a clerk, who, before entering upon the discharge of his duties as such, shall take an oath of office, and give bond, with security to the acceptance of the common council, to secure the proper performance of his duties. The clerk shall attend all meetings of the council, and make and keep a record of their proceedings; and the minutes of the proceedings of each meeting being recorded, shall be read over in the presence of the council, and if incorrect, corrected, and when found correct, or made so, shall be signed by the mayor, or other presiding officer of the meeting, and attested by the clerk, or other person acting as such.

"SEC. 27. It shall also be the duty of the clerk to safely keep and preserve all records, books, and papers belonging to the city of Evansville, and appertaining to or deposited in his office, entire and without injury or mutilation, and to hand them over, together with all other property of said city in his hands, to his successor, and to do and perform all other things and duties that he may be required to do by the by-laws, ordinances, rules, and regulations to be passed, ordained, and established by said common council: This act shall be deemed and taken to be a public act, and as such may be read as evidence in any court, without being pleaded or particularly referred to in pleading; and the printed by-laws and ordinances passed and ordained by said common council, and purporting to be printed by the order and under the authority of said common council shall be received and read in all courts as *prima facie* evidence, without being specially pleaded or referred to in pleading; and transcripts of the records and proceedings of the said common council, certified by the mayor, under the corporate seal, shall be evidence in all courts, in like manner as the original would be, without other proof or authentication than such certificate and seal."

In the said case of *Evansville vs. Dennett*, 161 U. S., 434, the question presented to the Supreme Court of

the United States was whether the ordinances and resolutions (kept of record under these express provisions of the charter of the city of Evansville above quoted) must be examined by the holder of a bond, which recited that it was issued under or by virtue of the charter of the city of Evansville. The Supreme Court held that the *bona fide* holder of such bond need not make such examination.

Note that in this **Evansville case the very act under which the bonds were issued required full and complete records to be kept.** It is not stated in the opinion of the Supreme Court, nor did that court deem it material to state in its opinion what the ordinances of the city of Evansville would have shown, or what the resolution of May 23, 1870, would have shown to the *bona fide* holders if they had been examined. What the court held was that they **need not be examined for any purpose**, no matter what they contained; that all that the *bona fide* holder of the bond needed to examine was the constitution and statute and the bond.

Furthermore, in the present case the statute of California does not require, as this court erroneously seems to assume, that the ordinance shall set forth the notice of election, nor does it require that the ordinance shall state what indebtedness is to be refunded.

The city council of Santa Cruz, acting strictly in accordance with the statute, might have authorized the giving of notice of election *without setting forth such notice in the ordinance.* The principle, therefore, applies that, even if a bond purchaser were bound to examine the ordinance (and

he is not) or have constructive notice of its contents, yet he *would have constructive notice of only what the statute requires to be stated in the ordinance*, and, therefore, he would not have constructive notice of the notice of election or of anything required by the statute to be stated in the notice of election, such as what indebtedness is to be refunded.

The statutes authorizing the registry and record of deeds, mortgages and other conveyances of lands and prescribing forms of acknowledgment provide that instruments thus authorized to be recorded and recorded, shall be constructive notice. The courts universally hold that if an instrument is not authorized by the statute to be recorded, *actual* recording of it will not be constructive notice to any one. See on this point the numerous cases and authorities on this brief *(infra*, pp. 39-43*)*.

For the same reason, even if the ordinance calling the election in the present case were constructive notice (and it was not), yet the insertion in such ordinance of the notice of election did not make such notice of election constructive notice to any bond purchaser, because such insertion was not provided for or required by the statute.

But even if the California statute had required that the ordinance describe fully what indebtedness was to be refunded, yet in this respect the case would be no different from the ordinary case of an issue of refunding bonds.

The common practice, if not the universal practice, and the common requirement of the statutes in the case of issuing bonds is to set forth in the ordinance the purpose of issue. In numerous cases in the Supreme Court of the United States bonds have thus been issued for an illegal purpose, and the ordi-

nances, resolutions and other proceedings of the municipality if examined would have shown that they were issued for an illegal purpose, but that court has uniformly held that the *bona fide* holder of such bonds is not bound to examine such ordinances, resolutions and other proceedings.

This court, in its opinion in the present case, states:

"On the contrary, the statute itself was clear notice to every person that upon the records of the governing body of the city was required to be entered the specific indebtedness proposed to be refunded."

This, we submit, is clearly an error. What the statute requires in the case of these Santa Cruz bonds is that "the notice of such election shall recite the indebtedness to be refunded," and it is nowhere required that the notice of election shall be spread upon the records. The very reason, therefore, on which this court has attempted to distinguish these cases from the other numerous cases to the contrary decided by the Supreme Court of the United States falls to the ground.

But even if it be assumed that it was required by the statute that the specific indebtedness proposed to be refunded should be set forth in the ordinance or resolution authorizing the bonds, yet the case of *Evansville vs. Dennett*, 161 U. S., 434, where the charter of the city of Evansville expressly required all the ordinances and resolutions to be entered on the records of the city, and the case of *Graves vs. Saline County*, 161 U. S., 359, where, as stated above, the county refunding bond act expressly required the officer to enter upon his record "the description of the bond or evidence of indebtedness for which, or for the purchasing or retiring of which the same was given" (S. L., Ill., 1879, p. 231) expressly hold that a *bona fide* holder of bonds

with recitals such as the present bonds contain *need not examine such ordinances, resolutions or proceedings of the municipality.*

The negotiability of municipal bonds and the conclusiveness of recitals therein in favor of a *bona fide* holder do not depend upon the question whether or not the charter of the municipality or the laws governing the same expressly require that certain records of the municipality be kept. It is the universal practice of municipalities to keep records, and everybody knows this, and courts take cognizance of the fact. Not only so, but in every instance, or in almost every instance, these records are kept under express requirements of the statute, and have been so wherever municipalities have been established. All these facts as to keeping records and as to the requirements of keeping records have been present in every one of the cases where municipal bonds have been held good in the hands of *bona fide* holders, notwithstanding what appeared in the ordinances, resolutions and other records of the municipalities issuing them. It is also safe to say that in every instance, or in almost every instance, a full and careful examination of these records might have disclosed the various illegalities complained of in the defenses set up against the various issues of bonds which have been held valid in the hands of *bona fide* holders. What the Supreme Court of the United States has repeatedly said is that the holder of negotiable municipal bonds with recitals need not examine such records of ordinances, resolutions and other proceedings. Any view which would narrow the negotiability of municipal bonds so as to make it obligatory upon any and every holder to examine the ordinances, resolutions and other proceedings of the municipality misconceives the very

purpose of having such municipal bonds negotiable, which is that the holder of the bond be not obliged to go there and examine all of the ordinances, resolutions and records of the municipality. To this effect are all the decisions of the Supreme Court of the United States.

Wesson vs. Saline County, also in Point in Plaintiff's Favor.

In *Wesson vs. Saline County*, 73 Fed. Rep., 917, in the Circuit Court of Appeals for the Seventh Circuit, the constitution and statutes of Illinois applicable to the bonds there in question authorized a *subscription* to the capital stock of a railroad company, but did not authorize a *donation*. **An examination of the proceedings and orders of the county court of Saline county would have shown to any one that the bonds were issued for a donation.** The precise question was whether the holder of the bonds, with the recitals therein contained, was bound to make such examination. If he was, then the bonds were invalid, even in the hands of a *bona fide* holder. The Circuit Court of Appeals for the Seventh Circuit had formerly decided a number of cases in which they had held such bonds invalid, even in the hands of a *bona fide* holder; but after the decision of the Supreme Court of the United States in the case of *Evansville vs. Dennett*, 161 U. S., 434, the Circuit Court of Appeals for the Seventh Circuit reversed its former decisions, holding them overruled by the Supreme Court of the United States in *Evansville vs. Dennett*, and held that a *bona fide* holder of such bonds, with such recitals, was not bound to examine the records of the county for any purpose, and the bonds were held valid in the hands of such *bona fide* holder.

In a note at the end of the decision, it is stated that "Mr. Justice HARLAN sat at the hearing, but did not participate in the decision."

Thus the Circuit Court of Appeals for the Seventh Circuit had previously held in *Post vs. Pulaski County*, 9 U. S. App., 1, that the **"recital in the bonds that they were issued pursuant to an order of the county court put whosesoever should come into possession of those bonds, even if purchased for value in the open market, upon inquiry as to the terms of that order."** This holding the Supreme Court of the United States overruled in *Evansville vs. Dennett, supra.*

In giving its opinion in the *Evansville case* the Court also says (p. 443):

"As therefore the recitals in the bonds import compliance with the city's charter, purchasers for value having no notice of the non-performance of the conditions precedent, were not bound to go behind the statute conferring the power to subscribe, and to ascertain, by an examination of the ordinances and records of the City Council, whether those conditions had, in fact, been performed. With such recitals before them they had the right to assume that the circumstances existed which authorized the city to exercise the authority given by the Legislature."

This decision of the Supreme Court of the United States, made upon great deliberation, and overruling prior decisions of the Circuit Court of Appeals of the Seventh Circuit from which the *Evansville case* came, shows that the Supreme Court stands by its prior decisions, and it completely negatives the position taken by the City of Santa Cruz when it asserts that the plaintiff, as the *bona fide* holder of the bonds and coupons in question, is put upon inquiry as to the terms of the ordinances, notices and resolutions under

which these bonds were issued, and charged with knowledge of their contents.

Note that the recitals in the bonds in the case of Evansville vs. Dennett were very much weaker than the recitals in the bonds now in question; and yet the Court had no hesitation in arriving at the conclusion that the bona fide holder was protected by even those recitals in the bonds, and was not bound to consult the ordinances and resolutions of the City Council.

After this decision by the Supreme Court of the United States, the case of *Wesson vs. County of Saline*, 73 Fed. Rep., 917, came before the United States Circuit Court of Appeals for the Seventh Circuit. That case was similar to the case of *Post vs. Pulaski County*, *supra*, and the Circuit Court of Appeals said (p. 919):

"**But the proposition enunciated in Post vs. Pulaski County, that 'the recital in the bonds that they were issued pursuant to an order of the County Court put whosoever should come into possession of those bonds, even if purchased for value in the open market, upon inquiry as to the terms of that order,' is inconsistent with, and must be regarded as overruled by the recent ruling of the Supreme Court in the case of City of Evansville vs. Dennett, supra,** where it was held that a recital that a subscription to the stock of a railroad company was 'made in pursuance of an act of the Legislature and ordinances of the City Council, passed in pursuance thereof * * * imported not only compliance with the act of the Legislature, but that the ordinances of the City Council were in conformity with the statute.' That is necessarily so, if the recitals in municipal bonds are not to be denied significance. The only reason for saying that a reference to an ordinance puts a party upon inquiry into the contents thereof is because the reference conveys knowledge of the exist-

ence of the ordinance. But Common Councils, Boards of Commissioners and like municipal bodies can act only by order, ordinance or resolution, as every one is bound to know; and, when a municipal bond is offered upon the market, it needs no mention in a recital to give a proposed purchaser notice that the bond was issued in pursuance of an order, or resolution, or ordinance. The existence of the bond implies that much, and when there is a recital to the effect that the bond was issued in pursuance of a statute, the necessary import is that there was an ordinance, and a proper one, whether express mention is made of it or not. To say, 'in pursuance of a statute and an ordinance,' is equivalent to an express statement that the ordinance is in conformity with the statute, and the purchaser of a bond containing that recital is not bound in that particular to look for further information."

Gunnison County Case Exactly in Point and Controlling.

In the case of *Gunnison County Commissioners vs. E. H. Rollins & Sons*, 173 U. S., 255 (in which case we were of counsel for E. H. Rollins & Sons), it was strenuously urged by Governor THOMAS in his brief and in his oral argument on behalf of Gunnison county that the *bona fide* holder of the Gunnison county bonds there in question was bound to examine the orders of the county commissioners of Gunnison county authorizing the issue of the refunding bonds, and that if he had made such examination he would have seen there a certificate of the county commissioners stating the amount of indebtedness of the county, and showing that it was beyond the limit prescribed by the constitution and statutes of the State. He says (His Brief, p. 40):

"Indeed, our contention is that the purchaser of bonds, or any other form of county indebtedness, *is bound to take notice of every county record open to public inspection* which contains a statement of the county indebtedness, whether it be a warrant register setting

forth the warrants that are issued from day to day, a bond register setting forth the amount of bonds issued from time to time, the semi-annual statements of indebtedness (which are nothing but trial balances struck twice a year), a certificate required to be made before the bonds are issued, *or any other public record of any kind, nature or description* that is open to the inspection of everyone."

We have said above that the Gunnison case is in point and controls the case at bar. This we have said deliberately because the whole defence of Gunnison County in the case was that the bondholder was bound *under the legislation of Colorado to take notice of the records of the county*, and that if such notice was taken the records would show on their face that the county was indebted beyond the constitutional limit, and to this end the defendant county introduced these records in evidence, and the whole stress of the case was whether under the recitals in the bonds a *bona fide* holder thereof was bound to take notice of the records, and the Court held that he was not. In support of his contention Governor THOMAS cited the same cases that are cited in the opinion of this Court in the present case, to wit: The case of *Dixon County vs. Field*, 111 U. S., 83, also the case of *Sutliff vs. Lake County Commissioners*, 147 U. S., 230. Governor THOMAS also cited the general county act of Colorado as to publishing and entering of record a statement of the county indebtedness, which act applied to every county in the State. It applied as much to *Gunnison* county as it did to *Lake* County, the defendant in the case of *Sutliff vs. Lake County Commissioners*. Section 30 of the said statute of the State was as follows:

"An act concerning counties, county officers and county government and repealing laws on these subjects, approved March 24, 1877.

"SEC. 30. It shall be the duty of the Board of County Commissioners of *each county* to make out semi-annual statements at the regular sessions in January and July, at which times they shall have such statement published in some weekly newspaper published in the county, if there be such published; and, if there be no newspaper published in the county, such Commissioners shall cause such statements to be posted in three conspicuous places in said county, one of which shall be the Court House door, and such statement shall show the amount of debt owing by their county, in what the debt consists, what payments, if any, have been made upon the same, the rate of interest that such debts are drawing, also a detailed account of the receipts and expenditures of the county for the preceding months, in which shall be shown from what officer and on what account any money has been received, and the amounts, and to what individuals and on what account any money has been paid, and the amounts; and shall strike the balance, showing the amount deficit, if any, and the balance in the treasury, if any, and the *statement thus made, in addition to being published as before specified, shall also be entered of record* by the Clerk of the Board of County Commissioners in a book to be by him kept for that purpose only, which book shall be open to the inspection of the public at all times *(Session Laws, Colorado, 1877, pp. 218, 227).*"*

Governor Thomas urged (and, of course, correctly on this point) that this Section 30 applied to *every county*, Gunnison County as well as Lake County. He also urged that the debt statements made under this section constituted a public record, of which every bond purchaser had constructive notice. He also argued that all other "records" of the county were constructive notice, especially the orders of the county board of commissioners authorizing the refunding bonds.

* The above section 30 is carried into the General Laws Compilation of 1887 and numbered therein as Section 457 of such Compilation.

This *Gunnison county case* was argued at the bar at great length by a large number of counsel, extra time being given by the court for the purpose, and the Supreme Court finally rendered its decision, in which it held that the Gunnison county bonds were valid in the hands of *bona fide* holders, holding, among other things, that the *bona fide* holder was not bound to examine the orders, proceedings or records of the county, nor the so-called financial statements entered upon the records of the county, although, if he had consulted them, he might have had notice that the refunding bonds were issued to refund invalid warrants. This decision in the *Gunnison county case* proceeds upon the true and correct ground of giving full meaning and effect to the negotiability of the municipal bond and to the recitals therein. This is a distinct decision to the effect that the holder of negotiable bonds is not bound to examine the ordinances, orders, resolutions and other proceedings for the issue of the bonds. The court, in concluding its opinion, says (p. 275) :

"It is insisted with much earnestness that the principles we have announced render it impossible for a State by a constitutional provision to guard against excessive municipal indebtedness. By no means. If a State constitution, in fixing a limit for indebtedness of that character, should prescribe a definite rule or test for determining whether that limit has already been exceeded or is being exceeded by any particular issue of bonds, all who purchase such bonds would do so subject to that rule or test, whatever might be the hardship in the case of those who purchased them in open market in good faith. Indeed, it is entirely competent for a State to provide by statute that all obligations, in whatever form executed by a municipality existing under its laws, shall be subject to any defense that would be allowed in cases of non-negotiable instruments. But, for reasons that every one understands, no such statutes have been passed. Municipal obligations executed under such a statute could not be readily disposed of to those who invest in such securities."

The opinion of the court does not expressly enumerate all the orders, financial statements, records and proceedings which the defendants introduced in evidence over the objections and exceptions of the plaintiff in that case. In regard to these the court says (p. 276) :

"What has been said renders it unnecessary to consider various questions arising upon exceptions to specific rulings in the Circuit Court as to the admission and exclusion of evidence, and as to those parts of the charge to which objections were made. *Those rulings are inconsistent with the principles herein announced.*"

Officers of municipalities charged with the duty of issuing bonds have power to make recitals therein.

It was strenuously urged by counsel for Gunnison County in the case of *Gunnison County Commissioners vs. E. H. Rollins & Sons*, 173 U. S., 255, that county officers had no power or authority conferred either by constitution or statute to make any recital on the question whether the debt limit prescribed by the constitution had been exceeded. It was urged that to permit such power would be to permit a mere officer of a municipality to recite away the provisions of the constitution. But the Supreme Court of the United States distinctly held contrary to this argument, and held such power to exist. There was not in that case any express power conferred either by constitution or statute upon the county officers to make findings and recitals in the bonds, yet the Supreme Court of the United States had no hesitation in holding that such power existed. This power to make the recitals results from the mere fact that these matters are by the statute committed to the officers of the municipality. The constitution and the statutes contemplate that some body of men shall act for and

on behalf of the municipality. There is no other administrative or executive body to represent the city or to speak for it in city matters. They are the agents of the city elected by the people of the city and identified with the city, and the city is bound by their acts and representations made in the performance of the duties committed to them by the statutes. Inasmuch as the city has chosen its own officers and agents, and hold these out to the public as their duly accredited agents and officers, the people of the city, alike by every principle of law and morality, are bound and estopped by the acts and representations of such officers and agents as against innocent third persons with whom they have dealt in city matters. The city and the people of the city held out these officers as representing the city and cannot be heard to assert the contrary.

In order that officers or boards of a municipality may have power to make findings and recitals in bonds it is not necessary that the statutes expressly confer upon such officers or boards power to make such findings and recitals. The fact is, as stated by the Supreme Court of the United States, that "such express direction and authority are seldom found in acts providing for the issuing of bonds." On this point it is enough in this Court to refer to the decision and language of the Supreme Court of the United States in *Bernards Township vs. Morrison*, 133 U. S., 523, 527, as follows:

"It were useless to refer to the long list of cases in which recitals, like these, have been held sufficient to sustain bonds in the hands of *bona fide* holders. It is urged that these commissioners were not elected by the people; that they were not the general officers of the township, but were special officers appointed by the Circuit Court—special agents as it were, for the specific purpose; that the statute does not in terms give them authority to determine whether the pre-

liminary conditions have been complied with; and that this case is, therefore, to be distinguished in these respects from those cases where similar recitals have been held conclusive. But though not the ordinary officers of the township, they were the ones to whom by legislative direction was given full authority in the matter of issuing bonds. The organization of townships, the number, character and duties of their various officers, are matters of legislative control; and it is not doubtful that officers appointed represent the municipality as fully as officers elected. When the legislature has declared how an officer is to be selected, and the officer is selected in accordance with that declaration, his acts, within the scope of the powers given him by the legislature, bind the municipality. But these special commissioners were not the only officers of the township whose acts gave currency to these bonds. If inquiry had been directed to the county and township records the affidavit of the township assessor to the consent required would have been found; and on the face of the bonds it appears that the county clerk of the county has added his official certificate to their validity; so that the acts of general as well as of special officers and agents of the township are the foundation upon which rests the validity of these bonds.

"While it is true that the act does not in terms say that these commissioners are to decide that all preliminary conditions have been complied with, yet such express direction and authority is seldom found in acts providing for the issuing of bonds. It is enough that full control in the matter is given to the officers named. In the case of *Oregon ex. Jennings*, 119 U. S., 74, 92, the rule is thus stated by Mr. Justice BLATCHFORD: 'Within the numerous decisions by this court on the subject, the supervisor and the town clerk, they being named in the statute as the officers to sign the bonds, and the "corporate authorities" to act for the town in issuing them to the company, were the persons entrusted with the duty of deciding, before issuing the bonds, whether the conditions determined at the election existed. If they have certified to that effect in the bonds, the town is estopped from asserting, as against a *bona fide* holder, that the conditions prescribed by the popular vote were not complied with.'

"Whatever may be the hardships of this particular case, to sustain the defenses pressed would go far towards destroying the market value of municipal

securities. We see no error in the ruling of the Circuit Court, and its judgment is therefore affirmed."

Bernards Township vs. Morrison, 133 U. S., 523, 527.

The express and specific recitals in the bonds, as well as the general recitals, estop the city from showing that part of the bonds refunded were not bonds of the city.

The bonds in the present case expressly recite not only that they are

"issued by the said city of Santa Cruz for the purpose of refunding **the bonded indebtedness of said city**" (the exact language of the statute), but also that they are

"issued * * * under and in pursuance of, and in conformity with, the provisions of an act of the legislature of the State of California, entitled," &c.;

and also specifically recite as to the notice of election:

"Notice thereof having been been duly and legally given and published in the manner as required by law."

Under the numerous decisions of the Supreme Court of the United States the *bona fide* holder of these bonds was not bound to look further and to examine the ordinances or notice of election authorizing these bonds. These bonds expressly and specifically recite that they are issued to refund **"the bonded indebtedness of said city."** This recital estops the city from asserting that what was refunded was not "the bonded indebtedness of said city." So also these bonds expressly and specifically recite "**notice**

thereof [that is, of the election] **having been duly and legally** given and published in the manner required by law." This recital also estops the city from showing that the notice of election was not "duly and legally given;" in other words, provided for voting upon refunding such bonds only as the statute authorized to be refunded. So, also, the general recital that the bonds are "**issued * * * under and in pursuance of and in conformity with the provisions of an act entitled,**" &c., estops the city from showing that the provisions of that act were not followed in issuing the bonds, as respects the bonds refunded, being city bonds, as well as in all other respects.

Vote of the People of the City and its Legal Effect.

The question was submitted pursuant to the Refunding Act of March 1, 1893, to a vote of the people of the city whether or not the indebtedness represented by the Water Company bonds, assumed by the city, as well as the other bonds of the city, should be refunded by the issue of the very bonds now here in question, and the people, at an election held on Tuesday, March 13, 1894, by a vote of 735 votes "for refunding the indebtedness" (including these Water Company bonds assumed by the city as fully set forth in the notice of election) and 22 votes against the same, voted in favor of refunding said bonds (Record, p. 395). The question put to the qualified electors was distinctly whether the city should issue bonds of said city under the provisions of the said refunding act of the State of California, that is, issue *negotiable* bonds, which should pass from hand to hand by delivery and

come, as these bonds have, into the hands of innocent holders for value. Afterwards, pursuant to, and expressly authorized by, such vote of the people, the city council issued the funding bonds now in question. When it comes to a question which should suffer, if the act of voting and issuing the bonds was illegal, there can be but one answer, either under strict law or moral justice: the city, and not the innocent holders of the bonds.

If the City ever intended to question or repudiate, or attempted to question or repudiate, these bonds of the water company which the city had assumed on the purchase of the water plant, that would have been the time for it to do so; but, instead of doing so, the people of the city, by their vote, with practical unanimity, agreed that this bond indebtedness should be paid as the bonds of the city, and that refunding bonds should be issued therefor.

We may here pause to quote from the language of the late Chief Justice of the Supreme Court of the United States in the somewhat similar case of *Jasper County vs. Ballou*, 103 U. S., 745—language which is especially pertinent to the facts just stated. Mr. Chief-Justice WAITE, giving the unanimous opinion of the court, there said (p. 751):

"When, therefore, the people were called on to vote whether the old bonds should be funded, the facts they had to consider were these: A valid law authorizing the subscription and an issue of the bonds had been passed. The people, at an election which had been irregularly called, had voted to make the subscription and issue bonds bearing ten per cent. interest, and all payable within six years. An act had been passed to legalize the election, and under it the subscription which had been voted was made, and bonds such as were contemplated had been issued and were then outstanding in the hands of various parties. Whether these bonds were valid was, so far as any direct de-

cisions were concerned, an open question, and certainly not free from doubt. Under these circumstances the question was directly put to the people of the county, in a manner authorized by law, whether they would recognize these bonds as 'binding and subsisting legal obligations,' and issue in lieu of them other bonds having twenty years to run and bearing seven per cent. interest instead of ten; and they, by their vote, said they would. There is no complaint of any illegality in this election, or of fraud or imposition. So far as the record shows, the proposition to fund went from the county authorities to the bondholders, and not from the bondholders to the county. The facts were as well known to one party as the other. If the people intended to rely on their defenses to the old bonds, then was their time for them to speak and by their vote say they would not recognize them as binding obligations. By voting the other way, they, in effect, accepted them as legal and subsisting for the purposes of the proposed extension of time at reduced interest, and said to the holders, if the proposition was accepted, no question of illegality would be raised. Their offer having been accepted, they are now estopped from insisting upon an irregularity which they have by their votes voluntarily waived, with a full knowledge of the facts. The case is clearly, as we think, within the principle acted on by the Supreme Court of the State in *President and Trustees of the Town of Keithsburg vs. Frick*, 34 Ill., 405. **As was very properly said below by the learned circuit judge 'there must be an end of these contests and defenses some time or other.' There must be a time when the people in their political capacity are concluded by their contracts as much as individuals, and we think that where the people of a county, at an election held according to law, authorize their corporate or political representatives to treat certain outstanding county obligations as 'properly authorized by law' for the purpose of negotiating a settlement with the holders, and the settlement which was contemplated has been made, all contests as to the validity of the obligations must be considered as ended.**

"This disposes of all questions as to the excessive issue of bonds. For all the purposes of this case the original bonds must be taken as binding. The issue of the funding bonds did not increase the aggregate of

the indebtedness of the corporation, but only changed its form."

So, also, the language of the Supreme Court in the case of *Graves vs. Saline County*, 161 U. S., 359, is likewise especially pertinent. Mr. Justice SHIRAS, giving the unanimous opinion of the Court, there says with regard to certain refunding bonds of Saline County (in that case refunding void bonds) (p. 374):

"But when, in pursuance of the funding laws, the question whether the outstanding original bonds issued to the Belleville and Eldorado Railroad Company should be refunded in new bonds was submitted to the same constituent body that authorized the original issue, and when, in accordance with the vote so taken, and in formal compliance with the other directions of the funding laws, negotiable securities were issued and delivered in payment of the outstanding bonds, we know of no principle of law which forbids the county of Saline from such honorable discharge of its liabilities in the hands of innocent holders."

These decisions of the Supreme Court of the United States in the cases above referred to harmonize with the general doctrines and principles of the law as to negotiable paper and as to constructive notice.

No ordinance, notice of election or any "record" is constructive notice as to any negotiable paper unless a statute expressly so provides, and there is no such statute in California.

The proposition that the ordinance and notice of election are constructive notice to every holder of bonds as against the contrary specific and positive recitals in such bonds, and that they are constructive

notice in the absence of any statute which so provides recital or no recital, seems to us to be an alarming and revolutionary principle in regard to negotiable instruments for the payment of money. The general principle, we take it, is well settled that, in order to render a thing constructive notice, some statute must so provide. This is the principle laid down by the Supreme Court in the case of *Burck vs. Taylor*, 152 U. S., 634, 654 :

"If notice was essential to charge them, actual notice should have been given, at least in the absence of any statute providing some means for constructive notice."

The principles and rules as to constructive notice have had an extensive application in regard to conveyances of real estate in this country. The statutes of most, if not all of the States, expressly provide for a public office, known as the registry of deeds, where conveyances of real estate may be recorded. Such office is provided with books and indexes and is open to the public at all times, and any person interested may go and examine such books ; and these statutes *in all cases* further expressly provide that the record of an instrument, duly executed and duly acknowledged, shall be constructive notice of such instrument to all subsequent purchasers of the real estate affected thereby. The opening of the public office and the recording of these deeds without such provision that the deeds so recorded shall be constructive notice would have no effect as giving constructive notice to any one. This is evident from the numerous decisions of the courts to the effect that where a deed is improperly recorded (as, for example, where it has been improperly acknowledged), the record of it in the public records is not constructive notice to a subsequent purchaser. Why ?

Because in the absence of a statute which expressly so provides such record is not constructive notice.

In 20 American and English Encyclopædia of Law, page 600, summarizing the established rule of law, it is said:

"If an instrument is either not authorized by law to be recorded, or is not authorized to be recorded by reason of its defective execution or the failure to comply with the prerequisities to recordation, its enrollment on the records is of no effect, and it cannot be said that it will charge with constructive notice."

In *McEwen vs. Den*, 24 How., 242, the Court said (p. 244):

"The deed offered in evidence was recorded without legal proof of its execution, and, therefore, a copy of the record could not be evidence. The Court erred in admitting the copy to go to the jury."

In *Olcott vs. Bynum*, 17 Wall., 44, the Court said (p. 59):

"The original deed from Hovey to Olcott and Stephenson never having been registered, *and the registration of the copy being unauthorized*, it follows that the certified copy of the registered copy was a nullity, and could give no legal right to the grantees which the Circuit Court could recognize."

In *Buel vs. Irwin*, 24 Mich., 145, the Court said:

"Apart from the curative act of 1861, this certificate was plainly insufficient to authorize the deed to be recorded. To entitle a deed to registry, its execution by the grantor must be proved or acknowledged, and when acknowledged the evidence of the acknowledgment of execution by the grantor must appear by the certificate, and if the acknowledgment is taken abroad, before a Michigan Commissioner, his certificate must be authenticated by his seal. In this case, the certificate does not show that the grantor acknowledged that *he* executed the deed, and, hence, if otherwise regular, the certificate would be bad, and the proof of execution of the deed, required by the statutes as a prerequisite to registry, would be wanting (*Haden vs. Westcott*, 11 Conn., 129)."

In *Ely vs. Wilcox*, 20 Wis., 523, the Court held that, for want of a certificate of a Clerk that the notary taking the acknowledgment was such, and that his signature was genuine, the deed was not authorized to be recorded, and was, therefore, not notice to any one. Other decisions are cited in a note to this case in 91 Amer. Dec., 436.

Mr. Wade says: "The requirements of the statute, both in regard to the official character of the acknowledging officer and the contents of his certificate, must be complied with in every substantial particular, or the record of the instrument will be inoperative as constructive notice."

Wade on Notice, 2d Ed., Sec. 124.

In *St. John vs. Conger*, 40 Ill., 535, the Court said:

"It is insisted that the record of the copy of the deed from Madison County was sufficient to put subsequent purchasers upon inquiry. *To hold that parties ought to have been put upon inquiry by this record would be precisely the same thing as holding them affected with notice.* This would be giving to the record of an instrument, not entitled to be recorded, the same force as to notice that we give to one legally reduced to record. We do not think any authority can be found in support of this proposition. On the contrary, the familiar rule, and one laid down by this Court, is that the record of an instrument not entitled by law to be recorded is of no avail as notice (*Moore vs. Hunter*, 1 Gilm., 317). It is said that a purchaser, as a matter of fact, receives the same information from the record of a copy as from the record of an original instrument. That may be true. But the broad difference is this: The statute only authorizes the record of original instruments, and it makes that record conclusive evidence of notice. It matters not that a subsequent purchaser has not, as a matter of fact, seen the record. If the instrument has been legally recorded, the law presumes him to have seen it, and holds him to the consequences of such knowledge. Not so as to the registry of a copy. It may be that if a party can be clearly proven to have read the record, he should be held to have derived from it the same degree of actual knowledge that he would have derived from seeing a copy of an instrument in the hands of a

private individual. He might be considered as put upon inquiry. But the law does not presume him to have read the record of an instrument not authorized to be recorded. In the case before us there is no evidence that the defendant, and the intermediate parties through whom he claims from the heirs of McNemony, had actual knowledge of the record of the copy or had ever seen such record."

If such deeds *actually upon the registry* (but not entitled to be there) are not constructive notice to a person who confessedly has constructive notice of whatever is required to be there, much less is the notice of election in the present case constructive notice to any one, for no one need examine the ordinance to see the notice of election, as the statute does not require the ordinance to set forth the notice of election.

It is true that ordinarily the purchaser of a piece of *real estate* must take notice of any judgment and litigation in the courts of general jurisdiction affecting the title to such real estate. But real estate is property *not negotiable according to the law merchant*, and an entirely different rule prevails with regard to judgments or litigation affecting negotiable instruments.

How free negotiable paper is from any "*constructive* notice" is seen from the following, to wit:

The purchaser of negotiable paper is not bound to take notice (that is, does not have constructive notice) of any litigation pending, or any judgments which may have been previously rendered regarding such negotiable paper.

This principle has been repeatedly decided by the courts.

That a pending suit, or a judgment in any suit regarding negotiable bonds, is not constructive notice to a *bona fide* purchaser thereof was well settled by the Supreme Court upon great consideration in the case of *County of Warren vs. Marcy*, 97 U. S., 96. That court states as follows the question there presented (p. 105).

"This brings us to the second question; namely, whether the pendency of the chancery suit for vacating the proceedings of the supervisors, and preventing the issue of the bonds in this case, was in itself constructive notice to all persons of their invalidity, or of the objections raised against them. This question has an important bearing upon the case, for, whilst the bonds may be valid in the hands of a *bona fide* purchaser before maturity, and without notice of any defect or vice in their origin, this cannot be said in reference to one who has such notice, or who is chargeable therewith."

The court, after full consideration of the matter and review of the numerous authorities, answered that question in the negative.

So, also, the Supreme Court, in the case of *Carroll County vs. Smith*, 111 U. S., 556, said (p. 562):

"The defendant in error was no party to that suit, and the record of the judgment is therefore no estoppel. The bonds were negotiable, and there was, therefore, no constructive notice of any fraud or illegality by virtue of the doctrine of *lis pendens* (*County of Warren vs. Marcy*, 97 U. S., 96)."

See, also, to the same effect:

Orleans vs. Platt, 99 U. S., 676.

Cass County vs. Gillett, 100 U. S., 585.

Thompson vs. Perrine, 103 U. S., 806.

1 DILLON *Munic. Corp.*, 4th Ed., Sec. 514, and cases cited in State as well as Federal courts.

There is also another principle which is especially pertinent to the present case.

Where it is sought to affect the bona fide purchaser for value of commercial paper with constructive notice, the question is not whether he had the means of obtaining or might have obtained by prudent caution the knowledge in question, but whether not obtaining was an act of gross or culpable negligence.

On this subject we refer to the decision of the Supreme Court in the case of *Wilson ex. Wall*, 6 Wall., 83, where said Court approved the well-known judgment of Lord Chancellor CRANWORTH in *Ware ex. Lord Egmont*.

This doctrine applies especially to cases of negotiable paper (*Goetz ex. Bank of Kansas City*, 119 U. S., 551, 560).

Applying this principle to the present case, it is perfectly obvious that a person purchasing one of the bonds now in question, with its specific and positive recitals that these bonds are "issued by the said city of Santa Cruz for the purpose of refunding *the bonded indebtedness of said city*," is not guilty of gross or culpable negligence, or of any negligence whatever, in not looking up all of the records of said city before purchasing the bonds, or in believing and relying on the recital that what was refunded was "*the bonded indebtedness of said city*."

Even if it were to be assumed and held that a purchaser of negotiable bonds without any recitals would have constructive notice of the ordinances, resolutions and notices of election and would be bound at his peril to examine the same before purchasing the bonds (and if this were held to be so in the absence of any statute which provides that such ordinances, resolutions, and notices of election shall be constructive notice—a holding which we believe to be clearly erroneous), yet the recitals in the bonds would in such event constitute an estoppel, precisely on the same principle that an estoppel may and frequently does exist in respect to the title of real estate.

The statutes of most of the States provide for records of deeds and mortgages and other instruments of conveyance of land, and that such records shall be constructive notice to all subsequent purchasers. Nevertheless, the courts uniformly hold that a person may estop himself from relying upon the constructive notice which such records furnish.

This was held in a case in New York in regard to a municipal corporation. *Trustees, &c., of Town of Brookhaven vs. Smith*, 118 N. Y., 6. There the town had passed certain resolutions recognizing the title of the land in Smith, whereas the records showed that the title was not in Smith, and the Court of Appeals held that the town was estopped to assert or rely upon the record title. The court says (p. 641):

"The authorities in this state are all harmonious on the subject of estoppel *in pais*.

"When a party, either by his declarations or conduct, has induced a third person to act in a particular manner, he will not afterwards be permitted to deny

the truth of the admission if the consequence would be to work an injury to such third person or to some one claiming under him (*Wendell vs. Van Rensselaer*, 1 Johns. Ch., 344, 354; *Storrs vs. Barker*, 6 *id.*, 166; *Town vs. Needham*, 3 Paige, 545; *Dezell vs. Odell*, 3 Hill, 215; also see dissenting opinion of Judge BRONSON approved in 47 N. Y., 500; *Brown vs. Sprague*, 5 Denio, 545; *Plumb vs. Cattaraugus C. M. Ins. Co.*, 18 N. Y., 393; *Welland Canal Co. vs. Hathaway*, 8 Wend., 483; *Thompson vs. Blanchard*, 4 N. Y., 303; *Cent. Nat. Bk. vs. Nat. Bk. Commonwealth*, 50 *id.*, 575; *Armour vs. M. C. R. R. Co.*, 65 *id.*, 111-122; *N. Y. Rubber Co. vs. Rothery*, 107 *id.*, 310 316).

"Numerous cases where this principle has been applied to real estate are collected in Washburn on Real Property (vol. 3, chap. 2, sec. 6), to which reference is made. When so applied it is as effectual as a deed would be from the party estopped.

"The general rule deduced from all the authorities is that if once is induced to purchase land by the acts or representations of another designed to influence his conduct, and creating a reasonable belief on his part under which he acts that he is thereby acquiring a valid title to the same, the party who thus influenced him is estopped from setting up his own title, existing at the time of the purchase, against that of the purchaser.

"The various declarations of the town through the trustees and town meetings must be construed as a single representation. They were all *in pari materia*, and had one purpose — viz., to inform Smith that the town made no claim to the land he desired to purchase."

To hold that the ordinances, resolutions and notices of election can be introduced as evidence to overthrow the estoppel produced by the recitals in the bonds is for the City to invoke and use the doctrine of constructive notice to perpetrate a fraud. But Courts never permit this doctrine to be invoked for any such purpose.

This is a principle that will forever stand in the way of any person, whether natural or artificial, retracting such representations as those made in these bonds.

The question of fact as to whether the indebtedness which was being renewed by these refunding bonds *were valid bonds of the City was one peculiarly within the knowledge of defendant.* The purchaser of the bonds had no actual knowledge on the subject. He trusted to and relied upon these representations. The agents of the City, who made the representations, either *willfully falsified* or recklessly certified to that which they did not know, which was little better. The doctrine of the *Sutliff case*, as applied to any recitals in those bonds is one thing (even if that case really has any great importance after the decisions in *Evansville vs. Dennett* and *Gunnison County vs. Rollins, supra*), but the application of it to overthrow the recitals in these bonds would be another matter. What were these recitals made for ?

The city officers knew that these bonds would go on the market and would pass from hand to hand for value. They knew that these representations would give currency to the bonds. They knew they would reach the hands of men who would place their money in them as an investment. Now to allow defendant to allege the falsity of these representations would be to allow it to perpetrate a fraud—an *actual, willful and monstrous fraud.* This has never before been tolerated by a Court of justice. The recital of facts which the Courts have allowed to be disputed have related to facts implied rather than expressed. They were not recitals which, in their nature, were fraudulent, if false. The doctrine of constructive notice can never be invoked as an aid to the perpetration of a willful fraud. It is a doctrine used to balance and adjust equities where no fraud is intended. Suppose a man has a deed on record, but, for the purpose of defrauding a third party, tells him that his grantor has a per-

fect title, and induces him to buy the property. Will the doctrine of constructive notice aid in the fulfillment of the fraud? Certainly not. But where is there any difference, in principle, between the case supposed and the case at bar? These representations were with reference to definite, specific facts. There is no pretense that a *mistake* was made. They were calculated to *deceive*. A man is presumed to intend the natural results of his acts. They were of such a character that if—as is now claimed—they were absolutely false, they must be pronounced willfully *fraudulent*. Let us see what the Courts have said upon this subject.

In *Converse vs. Blumrich*, 14 Mich., 109, the Court said:

"The laws of constructive notice can never be so applied as to relieve a party from responsibility for *actual misstatements and frauds*."

In *Groton Savings Bank vs. Batty*, 30 N. J. Eq., 126, the Court said:

"The principle [that the possession of land is notice to others of the possessor's title] which the Lathrops invoke is intended for a shield to protect the equitable rights of those who are entitled to the consideration of equity. It will not be available as a *cover of fraud* nor will it be applied against equity."

In *Wild vs. Gibson*, 1 H. L. Cas., 605, the Court said:

"Constructive notice is resorted to from the necessity of finding a ground of preference between equities otherwise equal, but cannot be applied in support of a charge of *direct personal fraud*."

See, also, *Gill vs. Hardin*, 48 Ark., 412.

In *Stone vs. Covell*, 29 Mich., 359, the Court said:

"We have heretofore held that a man is bound by his positive and unequivocal assertions of fact, and bound to made good the consequences of their false-

hood. And when he asserts as true what he has reason to believe false, and gives no qualification to show that he is not speaking positively and from knowledge, we think there is no sense or justice in exempting him from responsibility (*Converse vs. Blumrich*, 14 Mich., 109; *Beebe vs. Knapp*, 28 Mich., 53; *Beatty vs. Lord Ebury*, L. R., 7 H. of L., 102)."

The principle of constructive notice is always resorted to in order to prevent the person having it from doing an act to the injury of another, and does not apply where the question is whether one was barred by his assent to a *fraud practiced on him* (*Spencer vs. Spencer*, 3 Jones Eq., 404).

The defendant in this case is pleading its *own fraud*. It is asking to be permitted to show that its positive statements of facts *were false*—not false by mistake, but *willfully false*. It does this upon the flimsy pretext that it had made another record, at another time, from which, if the purchaser of these bonds had examined it, he would have ascertained that this latter statement was false. Even if this conclusion, as to what the former record would show, were correct, we deny that the fraud can be evaded in that way. This former record could only give constructive notice, and that is inadequate to repel a positive fraud.

Back of these recitals was an order entered of record prescribing what the bond should recite (Record, p. 142). Suppose there was some conflict between these records. Which was a purchaser entitled to believe? The recital was the later record. It was *specific and certain* as to the bonds being issued to refund "bonded indebtedness of said city." It related to a matter not only peculiarly within the knowledge of defendant, but one that it was its *duty* to investigate.

As to this question of fraud, it will not do to try to

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make a scapegoat of the City Council and plead the innocence of the people of this city. The people voted these bonds under a notice of election, specifying and describing the bonded indebtedness to be refunded. The procedure of the council was all entered of record. The whole transaction was open and public. During the period that these bonds, containing these recitals, were being issued, no taxpayer came forward and objected to their issuance or to the recitals they contained.

Public Policy Requires that the Negotiable Character of Municipal Bonds be Fully Maintained.

The character of municipal bonds as negotiable securities has been well settled by scores of decisions in the Courts. As such negotiable securities, easily marketable, passing from hand to hand, they constitute a desirable and convenient investment for money. The importance of preserving to its fullest extent the negotiable character and standing of such securities is fully as great to the municipalities themselves as to the purchasers of such securities. It is their negotiability that is the chief element of their desirability as an investment, and that has resulted in the reduction of the interest on these securities to the present low rates. But once let it be understood among the investing community, who constitute the market for these municipal bonds, that such securities are not negotiable, but that a purchaser of them—it may be in the City of New York, or Boston, or Philadelphia, or Washington, or Chicago—must himself take a journey to Santa Cruz, California, and search out records that existed five, ten, twenty or even thirty years before

his contemplated purchase of bonds, and inform himself in regard to all those records before he completes his purchase—we say, once let this be understood, and the market for municipal securities is gone. We do not believe that this Court will give its assent to any such doctrine, or that it is going to hold that a notice of election or an ordinance of the city is *constructive* notice to all the world, affecting the city's negotiable bonds, into whosesoever hands they may come, and also can be used as a defense against bonds in the face of the specific and solemn recitals therein contained. Such is not the doctrine of the Supreme Court of the United States. On the contrary, that Court has expressly stated and held in *Evansville vs. Dennett*, 161 U. S., 434, *supra* (p. 443):

"As therefore the recitals in the bonds import compliance with the city's charter, purchasers for value having no notice of the non-performance of the conditions precedent, were not bound to go behind the statute conferring the power to subscribe, and to ascertain, by an examination of the ordinances and records of the City Council, whether those conditions had, in fact, been performed. **With such recitals before them they had the right to resume that the circumstances existed which authorized the city to exercise the authority given by the Legislature.**"

So also, in *Marcy vs. Oswego Township*, 92 U. S., 637 (the leading case in respect of the effect of an *over-issue* of bonds where the limit is fixed by statute), the recital was as follows (p. 639):

"This bond is executed and issued by virtue of and in accordance with an act of the Legislature of said State of Kansas, entitled 'An act to enable municipal townships to subscribe for stock in any railroad, and to provide for the payment of the same, approved Feb. 25, 1870,' and in pursuance of and in accordance with

the vote of three-fifths of the legal voters of said Township of Oswego, at a special election duly held on the seventeenth day of May, A. D. 1870."

The Court says that the bonds are valid:

"Unless they were voted and issued in excess of the amount authorized by the act. It became, therefore, a question whether in this suit, brought by a *bona fide* holder for value to recover the amount of some of the coupons, it could be shown, as a defence to a recovery, that at the time of voting and issuing the series of bonds the value of the taxable property of the township was not in amount sufficient to authorize the voting and issuing the whole series, amounting to $100,000."

The Court held that such defense could not be made; and, on this point said (p. 641):

"So, also **the subsequent issue of the bonds containing the recital above quoted**, that they were issued 'by virtue of and in accordance with' the legislative act, and 'in pursuance of and in accordance with the vote of three-fifths of the legal voters of the township,' **was another determination not only of the result of the popular vote, but that all the facts existed which the statute required, in order to justify the issue of the bonds.**"

II.

We respectfully submit that this court erred in holding that the city of Santa Cruz did not have as "an outstanding indebtedness evidenced by bonds" the bonds of the water company issued under and secured by the water company's mortgage. The city of Santa Cruz had purchased the plant of the water company subject to the mortgage securing the said bonds, and also

assuming and agreeing to pay the said bonds, and therefore the city of Santa Cruz had these bonds as "an outstanding indebtedness evidenced by bonds" within the meaning of the act of March 1, 1893 (Stat. 1893, p. 59), authorizing the issue of refunding bonds.

Section 1 of the Statute of California authorizing the issue of refunding bonds provides:

"Whenever any incorporated city or town other than cities of the first-class in this State has an outstanding indebtedness evidenced by bonds and warrants thereof, the common council, board of trustees or other governing body thereof shall have power to submit to the qualified electors of such city or town, at an election to be held for that purpose, the question of refunding such indebtedness," &c.

The proposition that we here state is that, inasmuch as the city of Santa Cruz purchased the water company's plant subject to the mortgage made by the water company, and assumed and expressly agreed to pay the said water company's bonds, the city of Santa Cruz thereby became indebted for and bound to pay the said bonds, the city thus becoming the principal debtor upon the said bonds. The deed from the water company to the city expressly provides as follows (Record, p. 346):

"Subject, however, to said mortgage or deed of trust and all the obligations thereby imposed, which bonds, mortgage or deed of trust and obligations the party of the second part [the city of Santa Cruz] agrees to pay and perform."

This deed was received and accepted by the city, and filed for record by the city clerk (Record, p. 348).

We submit that on these facts it is clear, within the numerous decisions of the State of California, that the

city of Santa Cruz became primarily liable for the payment of the bonds of the water company.

In the case of *Williams vs. Naftzger*, 103 Cal., 438, the court says (p. 440):

"An agreement on the part of a grantee to pay and discharge a mortgage debt upon the granted premises, for which his grantor is liable, renders the grantee liable therefor to the mortgagee, and in an action for the foreclosure of the mortgage, if the mortgaged premises are insufficient to satisfy the mortgage debt, judgment may be rendered against him as well as against the mortgagor for the amount of such deficiency. This liability results from the familiar doctrine in equity that a creditor is entitled to the benefit of all securities or collateral obligations that his principal debtor may have given to the surety for the payment of the debt. By the conveyance of the mortgaged premises and the assumption of the mortgage debt by the grantee, the latter, as between him and his grantor, becomes primarily liable to the mortgagee, and his vendor becomes his surety (*Halsey vs. Reed*, 9 Paige, 452; *Crowell vs. Currier*, 27 N. J. Eq., 154; *Crawford vs. Edwards*, 33 Mich., 354; *Keller vs. Ashford*, 133 U. S., 622; *Biddel vs. Brizzolara*, 64 Cal., 354; Jones on Mortgages, secs. 741, 752)."

So, also, in the case of *Alvord vs. Spring Valley Gold Company*, 106 Cal., 547, a California corporation had taken a deed executed by another corporation subject to indebtedness of the grantor corporation secured by a certain mortgage therein mentioned. The court says (p. 552):

"The deed referred to contains an unequivocal recognition of the mortgage in question as a valid and subsisting obligation and lien on the property, and a promise to pay it as a part of the consideration for the conveyance. It is settled by an almost unanimous line of decisions in this country, approved by all text writers, that such a recital in a deed, even when the deed is not executed by the grantee, is conclusive evidence in favor of the mortgagee and against the grantee in the deed of the existence and validity of the mortgage."

In *Weaver vs. McKay*, 108 Cal., 546, a conveyance was made subject to a certain mortgage which the grantees therein assumed and agreed to pay. The court held that the grantees thereby assumed payment of the mortgage debt, and became liable to pay judgment for deficiency if the land did not sell for enough to pay the debt.

In *Hopkins vs. Warner*, 109 Cal., 133, the court says (p. 136):

"By the purchase of the mortgaged premises, and the agreement on the part of the purchaser to discharge the mortgage debt, there results, as between the mortgagor and his grantee, a substitution of the liability to the mortgagee, by which the grantee becomes the principal debtor to the mortgagee, and the liability of the mortgagor merely that of a surety for his grantee. This agreement of the grantee to discharge the mortgage debt is an obligation in the hands of the mortgagor, which the mortgagee may enforce for his own benefit when he seeks to obtain satisfaction of the mortgage debt, to the same extent that it could be enforced by the mortgagor."

So, also, in *Tulare County Bank vs. Madden*, 109 Cal., 312, the deed of conveyance recited a mortgage, and that the second party "assumes and agrees to pay the said amount due thereon." The court held that the grantee was liable on the mortgage as the principal debtor, and that a deficiency judgment was properly rendered against him on the foreclosure of the mortgage.

To the same effect see *Keller vs. Ashford*, 133 U. S., 610.

See, also, on this point JONES on *Mortgages*, 5th edition, section 749 *et seq.*

In order that the grantee may be personally liable to

pay the mortgage debt, it is not necessary that he should sign the deed or any obligation.

JONES on *Mortgages*, section 752, states this matter as follows:

"To create a liability on the part of the grantee to pay an existing mortgage, it is not necessary that he should sign the deed or any obligation; his acceptance of a deed imposing this obligation upon him is all that is necessary."

See also on this point the several California cases above quoted.

For these reasons we say that the bonds and mortgage of the water company, thus assumed and agreed to be paid by the city, did in fact and in law constitute "an indebtedness of the city evidenced by bonds thereof" within the meaning of the refunding statute.

Let us consider the position taken by the city as respects this alleged defense to the refunding bonds. The proposition of the city is that any purchaser of the refunding bonds, if he had examined the ordinance calling the election and the notice of election, would have seen on the face thereof that the city was refunding these bonds of the water company which the city had expressly assumed and agreed to pay, which fact of assumption and agreement to pay is stated upon the face of the said ordinance and notice of election. The ordinance calling the election refers to these water bonds as follows (Record, p. 129):

"Which said bonds outstanding were, at the time of the conveyance by the City Water Company of Santa Cruz to the city of Santa Cruz, of the property known as the city water works, and now are, a valid lien and charge upon said property known as the city water works, and became thereby a part of the bonded indebtedness of the city of Santa Cruz."

Consider what impression and information this statement would give to a proposed purchaser of the refunding bonds if he had examined such ordinance and notice of election. It seems to us clear that any one reading this statement in the ordinance, be he layman or lawyer, would come to precisely the same conclusion regarding the matter as the Supreme Court of California, as stated in the numerous cases above quoted, namely, that the city of Santa Cruz became thereby primarily indebted to pay the bonds of the water company. This is the fair, practical and common sense view of the matter. It is a view which deals with the substance and real legal effect of the transaction, whereas the view taken by the city is one which can only be adopted, if at all, by raising and finding an artificial distinction and not looking at the real substance of the matter.

Bear in mind, moreover, that this is a defense which is sought to be raised against the *bona fide* purchaser of the refunding bonds. As we have shown in our argument, Point I., *supra*, the question whether a *bona fide* purchaser is to be held affected with notice of any illegality is to be determined by an examination of the question whether such *bona fide* purchaser was negligent or guilty of bad faith in making his purchase. Applying this test in the present case, it is perfectly obvious that no proposed purchaser of the refunding bonds would be guilty of any negligence or bad faith in purchasing the said bonds, even if he had seen or read the ordinance and notice of election authorizing the same. This ordinance would have informed him that the city was issuing these refunding bonds to refund in part bonds issued by the water company, but it would also have informed him that these bonds had, by the conveyance of the property by the Water Company, sub-

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ject to the mortgage, the city agreeing to pay the bonds, become in law and in fact a part of the bonded indebtedness of the city.

The question whether these water bonds of the city of Santa Cruz had become a part of the bonded indebtedness of the city was a question which the city council must necessarily determine before issuing the bonds. They made and set forth in the ordinance calling the election their finding that the said bonds had "become thereby a part of the bonded indebtedness of the city of Santa Cruz." This finding of the council was in itself a decision by the tribunal appointed by the refunding act to pass upon the question of issuing the refunding bonds. This decision involved a mixed question of law and fact, and the decision of this appointed tribunal is, under the numerous decisions of the Supreme Court of the United States, conclusive as respects the holder of the refunding bonds. Any other conclusion would involve the proposition that whenever indebtedness is refunded the proposed purchaser of the refunding bonds must go back and trace the indebtedness to its beginning and ascertain at its peril whether the said indebtedness is in all respects valid.

For these reasons we submit that, even if this court shall be of opinion that the holder of the refunding bonds had constructive notice of the ordinance calling the election, and also of the notice of election, which, however, we respectfully submit and show, under point I. of this brief, is contrary to the numerous decisions of the Supreme Court of the United States, yet the holder of such refunding bonds, if he had read such

ordinance and notice of election, would not have received notice of any illegality in the issue of the bonds, and would not have been guilty of any fraud or bad faith in taking the refunding bonds. On the contrary, he would have been informed and assured by the solemn recital made by the city council of Santa Cruz that the water bonds had "become a part of the bonded indebtedness of the city of Santa Cruz." Even under this view, therefore, the holder of these refunding bonds is entitled to recover in this action.

Conclusion and Concluding Suggestion.

We have submitted the foregoing argument to this court, in the full confidence that this court will be able to arrive at the conclusion that the bonds in question, with the recitals contained therein, are valid in the hands of the plaintiff, the *bona fide* holder thereof. If, however, this court shall, upon a full and careful consideration of the matter, and of the cases in the Supreme Court of the United States referred to in this brief, not be able to arrive at such conclusion, then we respectfully suggest, for the consideration of this court, whether it might not deem it appropriate to certify to the Supreme Court of the United States the questions involved in this case, following in this respect the practice under which questions affecting the validity of bonds have been certified to that court by the Circuit Courts of Appeals in the cases of *Graves vs. Saline County*, 161 U. S., 359, and *Evansville vs. Dennett*, 161 U. S., 434, and in many other similar cases.

Inasmuch as the questions and principles necessarily involved in this case are of transcendent importance, affecting, if the present decision of the Circuit Court of Appeals should stand, millions upon millions of negotiable securities which are really part of the public funds of the United States, and inasmuch as the judgment of the Circuit Court of Appeals is final, and the opinion already given was not unanimous, and no appeal or writ of error can be taken to the Supreme Court of the United States, and inasmuch as the present decision and judgment of the Circuit Court of Appeals affect with invalidity the total issue of $360,000 of bonds by the defendant city for supposed defects in the issue of only $89,000 thereof issued on account of the purchase of the water plant by the city, which supposed defects do not relate to the merits of the said $89,000 indebtedness (for the said amount is part of the purchase price of the water plant owned and enjoyed by the city), but only to the technical form of the city's obligation to pay said amount, —we respectfully suggest and earnestly urge upon the Court that, if it does not see its way clear to affirming the judgment of the Circuit Court of the United States, for the reasons above mentioned it will carefully consider the propriety of certifying as above suggested the decisive and vital questions in this case to the Supreme Court of the United States.

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